US — 1989
ATTACH. C-1

PROVISION FOR INCOME TAXES

Income taxes as a percentage of income before taxes decreased to 28.1% in 1989 from 30.5% in 1988. Excluding the effects of the 1988 non-recurring gain, the decrease in the effective tax rate is primarily attributable to the implementation of a new accounting standard and a change in permanent differences as discussed further in Note 7 to the Consolidated Financial Statements.

OTHER ITEMS

As part of a continuing effort to reduce costs and to streamline operations, the Company offered early retirement incentives to eligible management employees who retire on February 28, 1990. The Company anticipates acceptance from approximately 4,000 managers. These staffing reductions are necessary to help the Company achieve a cost structure that more properly reflects the competitive nature of the communications business. Technological change in the core telephone business has been the primary enabling factor in these staffing reductions. Due to the nature of the offering and the fact that it will be funded primarily out of pension trust assets, the cost of the program is not expected to be material to 1990 results of operations. Further downsizing may be required in 1990 and beyond.

The Company is in the process of obtaining the necessary approvals to merge its three operating telephone companies into a single legal entity to be renamed U S WEST Communications. The merger will complement the existing operating structure of telephone operations.

The Financial Accounting Standards Board (FASB) has proposed that companies begin accruing for postretirement health care benefits for active and retired employees effective in 1992, rather than accounting for such costs on a pay-as-you-go basis. The telephone companies began prefunding some retiree health care costs in 1989, as discussed in Note 9 to the Consolidated Financial Statements. Although operating costs would increase under this proposal, it is probable that much of the increase in costs would be deferred until such time as related revenues are collected. The FASB continues to study the issue.

LIQUIDITY AND CAPITAL RESOURCES

The Company's capital expenditures were $2,185.5 in 1989, compared to $2,278.7 in 1988. Capital expenditures of the telephone companies were $1,756.2 in 1989 and $1,789.2 in 1988. BetaWest's capital expenditures decreased $115.0 compared to the prior year.

The telephone companies' capital expenditure plans in 1990 include continued investment in fiber optic cable applications and the conversion of central offices to digital technology. During 1989, Integrated Services Digital Network (ISDN) deployment continued on schedule. As a result, 25 large business customers have ISDN "Solutions" capabilities compared to six in 1988. ISDN allows customers to send voice, data, video and facsimile messages simultaneously on the same line using existing wiring in the public telephone network. The telephone companies also plan to modernize their billing and other operating systems in 1990 as part of a continuing effort to improve telecommunications services for their customers. Capital expenditures of the telephone companies are expected to approximate $2,000.0 in 1990, an increase of 14% over 1989.

Capital expenditures by the telephone companies in 1989 were financed primarily by internally generated funds. The Company expects that 1990 expenditures will be similarly financed. The non-telephone operations, particularly the capital assets segment, utilized external sources of financing during 1989 and will utilize similar sources of financing in 1990 in conjunction with the portfolio growth of the capital assets segment.

The Company acquired Financial Security Assurance Holding Ltd. in December 1989 for $345.0. FSA, through its insurance company subsidiaries, is engaged in the business of writing financial guarantee insurance, principally of asset-backed securities and other collateralized obligations. The acquisition allows U S WEST to expand into one of the fastest growing segments of the financial services industry. The Company financed the acquisition internally.

USW Inc
1989

In addition, SFAS 96 required that the telephone companies record a regulatory liability of approximately $1,600.0 coincidental with the reduction of the deferred tax reserves from higher historical to lower current tax rates. The regulatory liability will be amortized over the lives of the related depreciable assets in accordance with the average rate assumption method required by the Tax Reform Act of 1986.

The aforementioned regulatory asset and deferred tax accounts have been increased, in accordance with SFAS 96, to reflect the tax effect of future revenue requirements.

Note 8:
Stock Incentive Plan

U S WEST maintains a Stock Incentive Plan for officers and key employees. The Human Resources Committee of the Board of Directors is responsible for the administration of the plan, which provides for the grant of options, the grant of stock appreciation rights (SARs) associated with stock options and the grant and sale of restricted and non-restricted stock. Options must be exercised no later than ten years after the date upon which the option was granted in the case of incentive stock options, and ten years and one month in the case of non-qualified stock options. A total of 6,000,000 shares of U S WEST common stock were reserved for issuance under the plan.

Data for outstanding options under the plan is summarized below:

	*Number of Shares**	*Average Option Price*
Outstanding at January 1, 1987	811,000	$40.91
Granted	167,000	51.54
Exercised	(2,982)	33.56
Cancelled or expired	(49,000)	42.92
Outstanding at December 31, 1987	926,018	42.74
Granted	494,200	53.90
Exercised	(391,819)	37.90
Cancelled or expired	(31,364)	46.78
Outstanding at December 31, 1988	997,035	50.05
Granted	104,700	65.75
Exercised	(193,706)	45.04
Cancelled or expired	(54,498)	53.73
Outstanding at December 31, 1989	853,531	$52.88

**Includes options granted with SARs.*

Options to purchase 324,515 shares were exercisable at December 31, 1989. A total of 4,557,962 shares of U S WEST common stock were available for grant under the plan at December 31, 1989.

Note 9:
Pension and Other Benefits

U S WEST and its subsidiaries have two defined benefit pension plans which cover substantially all management and non-management employees. Benefits for management employees are based upon a final pay formula while benefits under the non-management plan are based upon a flat-benefit formula.

U S WEST uses the projected unit credit method for the determination of pension cost for financial reporting purposes and the aggregate cost method for funding purposes. No funding was required in 1989, 1988 or 1987.

USW Inc
1989

The following tables set forth the composition of the pension credit in 1989, 1988 and 1987 and the funded status of the plans at December 31:

	1989	*1988*	*1987*
Details of pension credit:			
Service cost—benefits earned during the period	$ 118.3	$ 107.0	$ 121.0
Interest cost on projected benefit obligation	415.5	393.8	396.5
Actual return on plan assets	(1,501.5)	(867.6)	(486.1)
Net amortization and deferral	858.7	319.7	(38.3)
Gain due to curtailment	—	—	(9.2)
Net pension credit	$ (109.0)	$ (47.1)	$ (16.1)
Funded status of the plans:			
Accumulated benefit obligation, including vested benefits of $3,960, $3,675 and $3,415 respectively	$4,170.0	$3,845.0	$3,725.0
Plan assets at fair value, primarily stocks and bonds	$8,271.0	$7,120.0	$6,575.0
Less: Projected benefit obligation	5,210.0	4,810.0	4,685.0
Plan assets in excess of projected benefit obligation	3,061.0	2,310.0	1,890.0
Less: Unrecognized experience gain	1,655.0	924.0	520.0
Prior service cost not yet recognized in net periodic pension cost	51.0	55.0	—
Unrecognized net asset at January 1, 1987	1,270.0	1,355.0	1,441.0
Prepaid (accrued) pension cost	$ 85.0	$ (24.0)	$ (71.0)
Actuarial assumptions:			
Weighted average discount rate	8.50%	8.75%	8.75%
Expected long-term rate of return on plan assets	9.25	8.75	8.50
Rate of increase in future compensation levels	5.50	5.50	5.50

The decreases in pension costs were primarily due to favorable investment experience and a corresponding increase in assumed actuarial rates of return.

Future anticipated benefit increases have been reflected in the above calculations.

In addition to pension benefits, U S WEST and most of its subsidiaries provide certain health care and life insurance benefits for retired employees. The cost of these benefits is generally recognized as incurred. In 1989, the Company also prefunded $65.8 of retiree health care costs, some of which were allowed for rate purposes in certain regulatory jurisdictions.

The total cost of health care and life insurance benefits for 1989 was $285.8 for U S WEST's 70,479 active and 29,409 retired employees.

NOTE 10:
COMMITMENTS AND CONTINGENCIES

The Company and its subsidiaries are engaged in various legal and regulatory actions, some of which involve substantial monetary claims. Additionally, members of the capital assets segment are party to various financial instruments, some of which could involve credit, interest rate and liquidity risks in excess of amounts recognized in the Company's consolidated financial statements.

At December 31, 1989, there were no known contingent liabilities, pending litigation and other claims that, in the opinion of management, would be material in relation to U S WEST's consolidated financial position.

1904

ATTACHMENT C-2

THE MOUNTAIN STATES TELEPHONE AND TELEGRAPH COMPANY
FORM 10-K

PART II

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS. (Dollars in millions)

EXPENSES

Total operating expenses were $2,930.6 in 1989, an increase of $42.0 or 1.5% compared to 1988.

Cost of services and products decreased $2.0 primarily because of lower repair expense and employee related costs, including a pension credit. This decrease was offset by the aforementioned changed settlement arrangements and increased billing from affiliates. Selling, general and administrative expenses increased $108.5 because of higher employee related costs resulting from a realignment of employees to sales and marketing functions, an increase in property and other taxes, and higher general business expenses. Depreciation and amortization expense decreased $64.5 primarily because of the aforementioned regulatory action in Colorado resulting in a disallowance of depreciation expense in the amount of $70.4.

Other income decreased because of a one-time charge of $9.1 associated with the Colorado regulatory action related to depreciation.

OTHER ITEMS

As part of a continuing effort to reduce costs and to streamline operations, the Company offered early retirement incentives to eligible management employees who retire on February 28, 1990. The Company has received notices of acceptance from approximately 1,600 managers as of February 1990. These staffing reductions are necessary to help the Company achieve a cost structure that more properly reflects the competitive nature of the communications business. Technological change in the core telephone business has been the primary enabling factor in these staffing reductions. Due to the nature of the offering and the fact that it will be funded primarily out of pension trust assets, the cost of the program is not expected to be material to 1990 results of operations. Further downsizing may be required in 1990 and beyond.

The Company has proposed to regulators a merger into U S WEST Communications. The merger will complement the existing operating structure of telephone operations.

The Financial Accounting Standards Board (FASB) has proposed that companies begin accruing for postretirement health care benefits for active and retired employees effective in 1992 rather than accounting for such costs on a pay-as-you-go basis. The Company began prefunding some retiree health care costs in 1989, as discussed in Note 3 to the Consolidated Financial Statements. Although operating costs would increase under this proposal, it is probable that much of the increased costs could be deferred until such time as related revenues are collected.

1989

NOTE 3: PENSIONS AND OTHER BENEFITS

U S WEST and its subsidiaries have two defined benefit pension plans which cover substantially all management and nonmanagement employees of the Company. Benefits for management employees are based upon a final pay formula while benefits under the nonmanagement plan are based upon a flat-benefit formula. The projected unit credit method is used for the determination of pension cost for financial reporting purposes and the aggregate cost method for funding purposes. No funding was required in 1989, 1988 or 1987.

Net pension credits for 1989, 1988 and 1987 were $50.7, $22.2 and $4.8, respectively. The decreases in pension costs were primarily due to favorable investment experience and a corresponding increase in assumed actuarial rates of return.

In addition to pension benefits, U S WEST and most of its subsidiaries provide certain health care and life insurance benefits for retired employees. The cost of these benefits is generally recognized as incurred. In 1989, the Company also prefunded $13.6 of retiree health care costs, some of which was allowed for rate purposes in certain regulatory jurisdictions.

In 1989, the Company's health care and life insurance benefits covering 28,574 active and 12,153 retired employees amounted to $133.0.

Attach C3

PART II

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Dollars in millions) (Continued)

EXPENSES

Total operating expenses were $1,904.7 in 1989, an increase of $100.5 or 5.6% compared to 1988.

Cost of services and products and selling, general and administrative expenses increased $50.0 and $42.4, respectively, compared to 1988. These increases were principally attributable to the aforementioned changed settlement arrangements with exchange carriers, increased billing from affiliates, higher repair and maintenance costs, and an increase in general business expenses. The increases were partially offset by a decrease in employee related expenses, including a pension credit, and a decrease in bad debt expense. Depreciation and amortization expense increased $8.1 primarily due to an increase in the amount of plant and a change in plant mix offset by decreases resulting from regulatory action.

Interest expense decreased $11.1 largely due to lower short-term borrowings over the period and lower interest on capital leases. Other income decreased primarily due to a one-time charge of $6.3 associated with the Minnesota refund.

OTHER ITEMS

As part of a continuing effort to reduce costs and to streamline operations, the Company offered early retirement incentives to eligible management employees who retire on February 28, 1990. The Company has received notice of acceptance from approximately 950 managers as of February 1990. These staffing reductions are necessary to help the Company achieve a cost structure that more properly reflects the competitive nature of the communications business. Technological change in the core telephone business has been the primary enabling factor in these staffing reductions. Due to the nature of the offering and the fact that it will be funded primarily out of pension trust assets, the cost of the program is not expected to be material to 1990 results of operations. Further downsizing may be required in 1990 and beyond.

The Company has proposed to regulators a merger into U S WEST Communications. The merger will complement the existing operating structure of telephone operations.

The Financial Accounting Standards Board (FASB) has proposed that companies begin accruing for postretirement health care benefits for active and retired employees effective in 1992 rather than accounting for such costs on a pay-as-you-go basis. The Company began prefunding some retiree health care costs in 1989, as discussed in Note 3 to the Financial Statements. Although operating costs would increase under this proposal, it is probable that much of the increased costs could be deferred until such time as related revenues are collected.

1989

NOTE 3: PENSIONS AND OTHER BENEFITS

U S WEST and its subsidiaries have two defined benefit pension plans which cover substantially all management and nonmanagement employees of the Company. Benefits for management employees are based upon a final pay formula while benefits under the nonmanagement plan are based upon a flat-benefit formula. The projected unit credit method is used for the determination of pension cost for financial reporting purposes and the aggregate cost method is used for funding purposes. No funding was required in 1989, 1988 or 1987.

Net pension credits for 1989, 1988 and 1987 were $26.0, $16.1 and $7.9, respectively. The decreases in pension costs were primarily due to favorable investment experience and a corresponding increase in assumed actuarial rates of return.

In addition to pension benefits, U S WEST and most of its subsidiaries provide certain health care and life insurance benefits for retired employees. The cost of these benefits is generally recognized as incurred. In 1989, the Company also prefunded $6.5 of retiree health care costs, some of which was allowed for rate purposes in certain regulatory jurisdictions.

In 1989, the Company's health care and life insurance benefits covering 15,328 active and 9,290 retired employees amounted to $57.7.

ATTACHMENT C-4

1989
ATTACH C-4

PACIFIC NORTHWEST BELL TELEPHONE COMPANY
FORM 10-K

PART II

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Dollars in millions)

EXPENSES

Total operating expenses were $1,600.0 in 1989, an increase of $42.1 or 2.7% compared to 1988.

Cost of services and products and selling, general, and administrative expenses increased $34.4 and $28.0, respectively, compared to 1988 as a result of employee related items, partially offset by a pension credit, increased billing from affiliates and higher general business expenses. Access expense also increased due to business growth. Depreciation and amortization expense decreased $20.3 primarily because of one-time adjustments in 1988 and decreases in 1989 resulting from regulatory action partially offset by an increase in depreciable plant.

OTHER ITEMS

As part of a continuing effort to reduce costs and to streamline operations, the Company offered early retirement incentives to eligible management employees who retire on February 28, 1990. The Company has received notices of acceptance from approximately 1,050 managers as of February 1990. These staffing reductions are necessary to help the Company achieve a cost structure that more properly reflects the competitive nature of the communications business. Technological change in the core telephone business has been the primary enabling factor in these staffing reductions. Due to the nature of the offering and the fact that it will be funded primarily out of pension trust assets, the cost of the program is not expected to be material to 1990 results of operations. Further downsizing may be required in 1990 and beyond.

The Company has proposed to regulators a merger into U S WEST Communications. The merger will complement the existing operating structure of telephone operations.

The Financial Accounting Standards Board (FASB) has proposed that companies begin accruing for postretirement health care benefits for active and retired employees effective in 1992 rather than accounting for such costs on a pay-as-you-go basis. The Company began prefunding some retiree health care costs in 1989, as discussed in Note 3 to the Financial Statements. Although operating costs would increase under this proposal, it is probable that much of the increased costs could be deferred until such time as related revenues are collected.

1989

PACIFIC NORTHWEST BELL TELEPHONE COMPANY
NOTES TO FINANCIAL STATEMENTS
(Dollars in millions)

NOTE 3: PENSIONS AND OTHER BENEFITS

U S WEST and its subsidiaries have two defined benefit pension plans which cover substantially all management and nonmanagement employees of the Company. Benefits for management employees are based upon a final pay formula while benefits under the nonmanagement plan are based upon a flat-benefit formula. The projected unit credit method is used for the determination of pension cost for financial reporting purposes and the aggregate cost method is used for funding purposes. No funding was required in 1989, 1988 or 1987.

Net pension credits for 1989, 1988 and 1987 were $32.8, $17.3 and $10.3, respectively. The decreases in pension costs were primarily due to favorable investment experience and a corresponding increase in assumed actuarial rates of return.

In addition to pension benefits, U S WEST and most of its subsidiaries provide certain health care and life insurance benefits for retired employees. The cost of these benefits is generally recognized as incurred. In 1989, the Company also prefunded $39.2 of retiree health care costs, some of which was allowed for rate purposes in certain regulatory jurisdictions.

In 1989, the Company's health care and life insurance benefits covering 14,757 active and 7,626 retired employees amounted to $57.4.

ATTACHMENT C-5

Jnc 1990

Management Discussion

C-5

The Minnesota plan, effective January 1, 1990, provides for equally sharing with customers earnings in excess of a 13.5 percent ROE up to a ROE of 18.5 percent, after which 100 percent of incremental earnings are returned to customers. The plan also requires that the remaining electromechanical switching offices in the state be replaced with digital switches at an estimated cost of $70. The sharing and network modernization plans are in effect through the end of 1994.

In New Mexico, beginning January 1, 1990, 55 percent of earnings in excess of a 13.75 percent ROE and 100 percent of earnings at or above a 20 percent ROE are returned to customers. Basic service rates are capped for three years while the Company has pricing flexibility for non-basic services. The plan requires the Company to invest approximately $20 in the design and construction of a state-of-the-art communications network to serve educational institutions. The sharing plan is in effect through the end of 1992.

Representatives of the state of Washington have approved a profit sharing plan, effective January 1, 1990. The plan includes certain rate caps and the sharing of earnings with customers, starting at 60 percent above a return on investment of 11.0 percent (a ROE of 13.72 percent) and declining to 40 percent at specified higher earnings levels.

Idaho has a revenue sharing plan in effect under which a portion of the growth in revenue per access line is shared with customers. The benefits of cost efficiencies and pricing freedom for non-basic services are retained by the Company.

In Nebraska, telephone rates have been subject to competitive pricing since 1986, except for basic exchange service which remains under limited regulatory jurisdiction. Similarly, North Dakota has price cap regulation that allows flexible pricing of non-essential services and has an indexed price cap on essential services.

The Company is awaiting an order on its proposed revenue sharing plan in the state of Oregon. U S WEST is also awaiting regulatory review of proposed earnings sharing plans in the states of Colorado, Iowa, Montana and Utah.

On September 19, 1990, the FCC adopted a system of price-cap regulation for interstate services provided by local exchange carriers and lowered the authorized rate of return from 12 percent to 11.25 percent, effective January 1, 1991. Rates were capped based on tariffs adjusted to 11.25 percent and will be adjusted July 1, 1991, and annually thereafter according to a pricing formula which includes factors for inflation, productivity and cost changes beyond the Company's control. Generally, earnings in excess of authorized levels will be shared equally with customers. The Company views price-cap regulation as positive for the industry in the long term. However, the required rate reductions resulting from the lower rate of return and the productivity factor represent challenges which could have negative earnings consequences for telephone operations in 1991.

Statement of Financial Accounting Standard No. 106

In December 1990, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard (SFAS) No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," effective for the Company commencing in 1993. Among other things, SFAS 106 requires that the Company adopt the accrual method of accounting for postretirement health care and other benefit costs associated with active and retired employees. The Company currently recognizes postretirement benefit costs as they are paid.

Adoption of SFAS 106 will significantly increase the recognition for accounting purposes of future postretirement benefit costs, most of which are attributable to the Company's telephone operations. Because telephone operations are subject to accounting rules applicable to regulated enterprises, the Company expects that a substantial portion of the additional costs will be recovered through the ratemaking process. However, the Company is unable to predict with any certainty what the future regulatory environment will be and the resulting impact of the new statement on the earnings of its regulated telephone operations. Adoption of the new standard for the Company's unregulated subsidiaries is not expected to have a significant effect on the Company's earnings. The Company continues to review the effect that health care plan changes, including cost sharing assumptions, cost trends and other factors may have on health care costs.

Inc
1990

cumulative amount of deferred tax benefits previously flowed through to ratepayers. These deferred tax amounts are being amortized over the lives of the related depreciable assets concurrent with their recovery through rates. The unamortized balance of the regulatory asset at December 31, 1990 is approximately $1,010.

In addition, SFAS 96 required that U S WEST Communications record a regulatory liability of approximately $1,600 coincidental with the reduction of the deferred tax reserves from higher historical to lower current tax rates. The regulatory liability is being amortized over the lives of the related depreciable assets in accordance with the average rate assumption method required by the Tax Reform Act of 1986. The unamortized balance of the regulatory liability at December 31, 1990 is approximately $1,420.

The aforementioned regulatory asset and liability have been grossed up, in accordance with SFAS 96, for the tax effect of future revenue requirements.

Note 9:
Stock Incentive Plan

U S WEST maintains a Stock Incentive Plan for officers and key employees. The Human Resources Committee of the Board of Directors is responsible for the administration of the plan, which provides for the grant of options, stock appreciation rights (SARs) associated with stock options and the grant and sale of restricted and non-restricted stock. Options must be exercised no later than ten years after the date upon which the option was granted in the case of incentive stock options, and ten years and one month in the case of non-qualified stock options. A total of 12,000,000 shares of U S WEST common stock are reserved for issuance under the plan.

Data for outstanding options under the plan is summarized below:

	*Number of Shares**	*Average Option Price*
Outstanding at January 1, 1988	1,852,036	$21.37
Granted	988,400	26.95
Exercised	(783,638)	18.95
Cancelled or expired	(62,728)	23.39
Outstanding at December 31, 1988	1,994,070	25.03
Granted	209,400	32.88
Exercised	(387,412)	22.52
Cancelled or expired	(108,996)	26.86
Outstanding at December 31, 1989	1,707,062	26.44
Granted	1,185,747	37.44
Exercised	(543,494)	26.17
Cancelled or expired	(42,532)	26.74
Outstanding at December 31, 1990	2,306,783	$32.13

**Includes options granted in tandem with SARs.*

Options to purchase 786,728 shares were exercisable at December 31, 1990. A total of 7,973,109 shares of U S WEST common stock were available for grant under the plan at December 31, 1990.

Note 10:
Pension and Other Benefits

U S WEST and its subsidiaries have two defined benefit pension plans which cover substantially all management and non-management employees. Benefits for management employees are based upon a final pay formula while benefits under the non-management plan are based upon a flat-benefit formula. U S WEST uses the projected unit credit method for the determination of pension cost for financial reporting purposes and the aggregate cost method for funding purposes. No funding was required in 1990, 1989 or 1988.

Inc
1990

The following table sets forth the composition of the pension credit and the actuarial assumptions of the plans:

	Year Ended December 31,		
	1990	1989	1988
Details of pension credit:			
Service cost—benefits earned during the period	$ 119.2	$ 118.3	$ 107.0
Interest cost on projected benefit obligation	438.1	415.5	393.8
Actual return on plan assets	175.4	(1,501.5)	(867.6)
Net amortization and deferral	(842.1)	858.7	319.7
Net pension credit	$(109.4)	$ (109.0)	$ (47.1)
Actuarial assumptions:			
Weighted average discount rate	8.50%	8.50%	8.75%
Expected long-term rate of return on plan assets	9.50	9.50	8.75
Rate of increase in future compensation levels	5.50	5.50	5.50

Following is the funded status of the plans:

	December 31,	
	1990	1989
Accumulated benefit obligation, including vested benefits of $4,192 and $3,960, respectively	$4,413.0	$4,170.0
Plan assets at fair value, primarily stocks and bonds	$7,093.0	$8,271.0
Less: Projected benefit obligation	5,495.0	5,210.0
Plan assets in excess of projected benefit obligation	1,598.0	3,061.0
Less: Unrecognized experience gain	191.0	1,655.0
Prior service cost not yet recognized in net periodic pension cost	29.0	51.0
Unrecognized net asset at January 1, 1987	1,105.0	1,270.0
Prepaid pension asset	$ 273.0	$ 85.0

Anticipated future benefit increases have been reflected in the above calculations.

Under an early retirement program for managers, approximately 4,000 employees elected to retire effective February 28, 1990. The payment of lump sum benefits to retiring managers reduced plan assets by approximately $642 in 1990.

In addition to pension benefits, U S WEST and most of its subsidiaries provide certain health care and life insurance benefits for retired employees. In 1990 and 1989, the Company also prefunded $56.9 and $65.8, respectively, of retiree health care costs, a portion of which was allowed for rate purposes in certain regulatory jurisdictions.

The cost of health care and life insurance benefits in 1990 was $218.6 and $83.0 for U S WEST's 64,850 active and 34,000 retired employees, respectively.

In December 1990, the Financial Accounting Standards Board issued SFAS No. 106 "Employers' Accounting for Postretirement Benefits Other Than Pensions" effective for the Company commencing in 1993. Among other things, SFAS 106 requires that the Company adopt the accrual method of accounting for postretirement health care and other benefit costs associated with active and retired employees. The Company currently recognizes postretirement benefit costs as they are paid.

Adoption of SFAS 106 will significantly increase the recognition for accounting purposes of future postretirement benefit costs, most of which are attributable to the Company's telephone operations. Because

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1990

telephone operations are subject to accounting rules applicable to regulated enterprises, the Company expects that a substantial portion of the additional costs will be recovered through the ratemaking process. However, the Company is unable to predict with any certainty what the future regulatory environment will be and the resulting impact of the new statement on the earnings of its regulated telephone operations. Adoption of the new standard for the Company's unregulated subsidiaries is not expected to have a significant effect on the Company's earnings. The Company continues to review the effect that health care plan changes, including cost sharing assumptions, cost trends and other factors may have on health care costs.

NOTE 11:
ACQUISITION OF MINORITY INTEREST IN U S WEST NEWVECTOR GROUP, INC.

On November 12, 1990, U S WEST announced its intention to acquire the approximately 19 percent of U S WEST NewVector Group, Inc. (NewVector) Class A common shares that it does not currently own in a stock-for-stock, tax-free merger. Upon consummation of the merger, each of the approximately 9.7 million NewVector Class A common shares not already owned by U S WEST would be converted into the right to receive .95 newly-issued shares of U S WEST common stock. The merger will be accounted for as a purchase and resulting goodwill will be amortized on a straight-line basis over a period of 40 years.

NOTE 12:
COMMITMENTS AND CONTINGENCIES

The Company and its subsidiaries are engaged in various legal and regulatory actions, some of which involve substantial monetary claims. At December 31, 1990, there were no known contingent liabilities, pending litigation or other claims that, in the opinion of management, would be material in relation to U S WEST's consolidated financial position.

NOTE 13:
ADDITIONAL FINANCIAL INFORMATION

The statements of income of U S WEST Communications, which is the dominant part of the communications and related services segment, are summarized below:

	Year Ended December 31,		
	1990	*1989*	*1988*
Local service revenues	$3,390.3	$3,329.0	$3,299.9
Access charges—interstate	2,093.4	2,217.2	2,237.5
Access charges—intrastate	586.8	518.7	454.4
Long distance network revenues	1,493.2	1,491.3	1,411.8
Miscellaneous revenues	529.1	542.9	675.2
Total revenues	8,092.8	8,099.1	8,078.8
Cost of services and products	2,189.1	2,242.8	2,160.3
Selling, general and administrative	2,370.7	2,527.5	2,404.9
Depreciation and amortization	1,674.8	1,562.5	1,639.2
Total operating expenses	6,234.6	6,332.8	6,204.4
Income from operations	1,858.2	1,766.3	1,874.4
Interest expense	417.6	411.4	413.1
Other income (expense)—net	(8.7)	(12.0)	3.1
Provision for income taxes	457.8	409.8	456.3
Net income	$ 974.1	$ 933.1	$1,008.1

1990
ATTACH. C-6

U S WEST COMMUNICATIONS, INC.
FORM 10-K

PART II

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS. (Dollars in millions)

OPERATING EXPENSES

Total operating expenses were $6,234.6 in 1990, a decrease of $98.2 or 1.6% compared to 1989.

Cost of services and products and selling, general and administrative expenses decreased $53.7 and $156.8 respectively, compared to 1989. These decreases were principally attributable to lower employee related expenses, primarily related to an early retirement program completed in the first quarter. Approximately 3,700 managers elected to retire effective February 28, 1990. The Company also experienced decreases in operating taxes, billings from affiliates and general business expenses. The decreases were partially offset by unusually favorable uncollectible expense in 1989.

Depreciation and amortization expense increased $112.3 primarily due to an increase in the amount of plant, change in plant mix and the effect of the 1989 refund in Colorado which reduced expense in that period by $70.4. The increase was partially offset by decreases resulting from regulatory actions.

Interest expense increased $6.2 largely due to higher short-term borrowings over the period partially offset by lower interest rates on short-term borrowings and lower interest expense on capital leases.

PROVISION FOR INCOME TAXES

The provision for income taxes increased $48.0 primarily as a result of higher income before taxes and a higher annual effective tax rate ("AETR"). The increase in the AETR results from lesser amortization of investment tax credits, higher state income taxes, and other rate differences. The 1989 AETR also reflects favorable adjustments resulting from the filing of prior years' tax returns.

OTHER ITEMS

In December 1990, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," effective for the Company commencing in 1993. Note 3 to the consolidated financial statements discusses this issue in more detail.

The Company has recently implemented alternative forms of regulation ("AFOR") in the states of Idaho, Minnesota, Nebraska, New Mexico, North Dakota and Washington and has proposed AFOR plans in Colorado, Iowa, Montana, Oregon and Utah. Additionally, on September 19, 1990, the FCC adopted price-cap regulation for interstate services and lowered the allowed rate of return from 12.0 percent to 11.25 percent. Although the Company views both interstate price-cap regulation and intrastate AFOR plans as positive in the long term, such plans could have negative short-term earnings consequences for the Company. AFOR and interstate price-cap regulation plans are discussed in more detail in the Business section, Item 1.

1990

The aforementioned regulatory asset and liability have been grossed up, in accordance with SFAS 96, for the tax effect of future revenue requirements.

NOTE 3: PENSIONS AND OTHER BENEFITS

U S WEST and its subsidiaries have two defined benefit pension plans which cover substantially all management and non-management employees of the Company. Benefits for management employees are based upon a final pay formula while benefits under the non-management plan are based upon a flat-benefit formula. The projected unit credit method is used for the determination of pension cost for financial reporting purposes and the aggregate cost method for funding purposes. No funding was required in 1990, 1989 or 1988.

Net pension credits for 1990, 1989 and 1988 were $92.2, $109.5 and $55.6, respectively. The pension credits are primarily due to favorable investment experience and, in 1989, a corresponding increase in assumed actuarial rates of return.

In addition to pension benefits, U S WEST and most of its subsidiaries provide certain health care and life insurance benefits for retired employees. In 1990 and 1989, the Company prefunded $50.2 and $59.3, respectively, of retiree health care costs, some of which was allowed for rate purposes in certain regulatory jurisdictions.

In 1990, the Company's health care and life insurance benefits covering 53,021 active and 33,512 retired employees amounted to $193.1 for active employees and $66.0 for retired employees.

In December 1990, the Financial Accounting Standards Board issued SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions," effective for the Company commencing in 1993. Among other things, SFAS 106 requires that the Company adopt the accrual method of accounting for postretirement health care and other benefit costs associated with active and retired employees. The Company currently recognizes postretirement benefit costs as they are paid.

Adoption of SFAS 106 will significantly increase the recognition of future postretirement benefit costs for accounting purposes. Because the Company is subject to accounting rules applicable to regulated enterprises, it expects that a substantial portion of the additional costs will be recovered through the ratemaking process. However, the Company is unable to predict with any certainty what the future regulatory environment will be and the resulting impact of the new standard on its earnings. The Company continues to review the effect that health care plan changes, including cost sharing assumptions, cost trends and other factors may have on health care costs.

USW Inc
1991

Management Discussion

A-7-C-7

Competition

Regulatory, legislative and judicial actions, and advances in technology have increased competition in the telecommunications business, the effects of which could result in price reductions and lower revenues. Competition from long distance companies is negatively impacting U S WEST Communications' market share of intraLATA long distance services such as WATS and "800" services. In addition, there are companies that offer or are planning to offer local service in competition with U S WEST Communications. At the current time, such competition from alternative local service providers is limited to providing large business customers redundant private line access to the facilities of interexchange carriers. In coming years, however, they represent potential sources of increasing competition for local service. Other sources of future competition include cable television and wireless communication companies. The impact of increased competition on the operations of U S WEST Communications will be influenced by the future actions of regulators and legislators.

The FCC has adopted a regulatory structure known as "Open Network Architecture," under which U S WEST Communications is required to unbundle its telephone network services in a manner which will accommodate the service needs of the growing number of information service providers. The impact of the FCC's actions are not currently determinable.

In July 1991, the United States District Court for the District of Columbia lifted the restriction on the Bell Operating Companies' provision of information services. Legislation has been introduced in Congress to reverse this Court action. At this time, however, U S WEST is able to offer a variety of new information services. The impact the offering of such services will have on the Company's future results of operations has not been determined.

Postretirement Benefits Other Than Pensions

In addition to pension benefits, U S WEST and most of its subsidiaries provide certain health care and life insurance benefits for retired employees. In December 1990, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard (SFAS) No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions." Among other things, SFAS 106 requires adoption by 1993 of the accrual method of accounting for postretirement benefits other than pensions. U S WEST currently recognizes the cost of postretirement benefits as they are paid.

The Company's estimate of the transition benefit obligation that will be recognized upon the adoption of SFAS 106 is a range of $2 to $3 billion, before income taxes. While the adoption of SFAS 106 will significantly increase the amount of future postretirement benefit costs recognized for accounting purposes, most of these costs will be attributable to the Company's regulated telephone operations. The Company will seek to recover these increased costs through the ratemaking process. It is not currently possible to reasonably estimate the future impact of SFAS 106 on the earnings of its regulated telephone operations. Adoption of the new standard for the Company's unregulated subsidiaries is not expected to have a significant effect on the Company's earnings. The Company continues to review the effect that health care plan changes, including cost sharing, cost trends and other factors, may have on health care costs.

Merger of NewVector

On July 11, 1991, shareowners of NewVector voted to approve the Company's merger offer, making NewVector a wholly-owned subsidiary of U S WEST. Pursuant to the merger, the Company issued approximately 11.1 million shares of U S WEST common stock valued at approximately $399 to former shareowners of NewVector. The merger was accounted for as a purchase and the resulting goodwill of approximately $375 is being amortized on a straight-line basis over a period of 40 years.

Other

Despite the continuing national recession, the regional economy served by U S WEST has been less severely impacted than has the national economy. Nonetheless, a protracted economic decline or a further worsening of the regional or national economies could adversely affect U S WEST's future revenues and earnings.

In August 1992, non-management labor contracts between certain U S WEST companies and various unions, including the Communications Workers of America and the International Brotherhood of Electrical Workers, will expire.

Inc
1991

NOTE 9: EMPLOYEE BENEFITS

Pension Plans

U S WEST has two defined benefit pension plans which cover substantially all management and non-management employees. Benefits for management employees are based upon a final pay formula while benefits under the non-management plan are based upon a flat-benefit formula. U S WEST uses the projected unit credit method for the determination of pension cost for financial reporting purposes and the aggregate cost method for funding purposes. No funding was required in 1991, 1990 or 1989.

The composition of the pension credit and the actuarial assumptions of the plans follow:

	Year Ended December 31,		
	1991	1990	1989
Details of pension credit:			
Service cost—benefits earned during the period	$ 124.0	$ 119.2	$ 118.3
Interest cost on projected benefit obligation	466.0	438.1	415.5
Actual return on plan assets	(1,312.0)	175.4	(1,501.5)
Net amortization and deferral	613.4	(842.1)	858.7
Net pension credit	$ (108.6)	$(109.4)	$ (109.0)
Actuarial assumptions:			
Weighted average discount rate	8.50%	8.50%	8.50%
Expected long-term rate of return on plan assets	9.50	9.50	9.50
Rate of increase in future compensation levels	5.50	5.50	5.50

The funded status of the plans follow:

	December 31,	
	1991	1990
Accumulated benefit obligation, including vested benefits of $4,426 and $4,192, respectively	$4,716.0	$4,413.0
Plan assets at fair value, primarily stocks and bonds	$8,024.0	$7,093.0
Less: Projected benefit obligation	6,036.0	5,495.0
Plan assets in excess of projected benefit obligation	1,988.0	1,598.0
Less: Unrecognized experience gain	554.0	191.0
Prior service cost not yet recognized in net periodic pension cost	27.0	29.0
Balance of unrecognized net asset at January 1, 1987	1,025.0	1,105.0
Prepaid pension asset	$ 382.0	$ 273.0

Anticipated future benefit changes have been reflected in the above calculations. The weighted average discount rate for determining the benefit obligation as of December 31, 1991 was 8.25%.

Postretirement Benefits Other Than Pensions

In addition to pension benefits, U S WEST and most of its subsidiaries provide certain health care and life insurance benefits for retired employees. During 1991, 1990 and 1989, the Company also prefunded $63.1, $56.9 and $65.8, respectively, of retiree health care costs. A portion of the prefunded amount was allowed for rate purposes in certain regulatory jurisdictions.

In December 1990, the Financial Accounting Standards Board issued SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions." Among other things, SFAS 106 requires adoption by 1993 of the accrual method of accounting for postretirement benefits other than pensions. U S WEST currently recognizes the costs of postretirement benefits other than pensions as they are paid. The cost of health care and life insurance benefits for the Company's retired employees in 1991 was $120.

Inc
1991

The Company's estimate of the transition benefit obligation that will be recognized upon the adoption of SFAS 106 is a range of $2 to $3 billion, before income taxes. While the adoption of SFAS 106 will significantly increase the amount of future postretirement benefit costs recognized for accounting purposes, most of these costs will be attributable to the Company's regulated telephone operations. The Company will seek to recover these increased costs through the ratemaking process. It is not currently possible to reasonably estimate the future impact of SFAS 106 on the earnings of its regulated telephone operations. Adoption of the new standard for the Company's unregulated subsidiaries is not expected to have a significant effect on the Company's earnings. The Company continues to review the effect that health care plan changes, including cost sharing, cost trends and other factors, may have on health care costs.

NOTE 10: INCOME TAXES

The components of the provision for income taxes follow:

	Year Ended December 31, 1991	1990	1989
Federal:			
Current	$ 429.4	$317.8	$233.3
Deferred	(226.8)	203.0	202.2
Investment tax credits—net	(74.9)	(70.5)	(80.1)
	127.7	450.3	355.4
State and local:			
Current	71.7	51.5	8.8
Deferred	(12.1)	58.8	70.0
	59.6	110.3	78.8
Provision for income taxes	$ 187.3	$560.6	$434.2

Deferred investment tax credits amortized were $75.4 in 1991, $72.6 in 1990 and $82.4 in 1989. The unamortized balance of investment tax credits at December 31, 1991 and 1990, was $586.0 and $659.8, respectively.

Amounts paid for income taxes were $484.3, $387.5 and $308.9 in 1991, 1990 and 1989, respectively.

The effective tax rate differs from the statutory tax rate as follows:

	Year Ended December 31, 1991	1990	1989
Federal statutory tax rate	34.0%	34.0%	34.0%
Investment tax credits	(4.6)	(4.2)	(5.1)
State income taxes—net	4.3	4.1	3.9
Rate differential on reversing temporary differences—net	(3.1)	(2.8)	(5.6)
Depreciation of capitalized overheads—net	2.2	2.3	3.0
Other	(1.8)	(1.5)	(2.1)
Restructuring charge	(5.7)	—	—
Effective tax rate	25.3%	31.9%	28.1%

1991

ATTACH. C-8

PART II

MANAGEMENT'S DISCUSSION. (Dollars in millions)

OTHER ITEMS

Regulatory Activity

On July 8, 1991, the Office of Consumer Advocate ("OCA") petitioned the Iowa State Utilities Board ("ISUB") for a prospective revenue reduction. In February 1992, the Company, the OCA and interveners agreed to an ongoing rate reduction in the amount of $41.0 and a refund accrued at the annual rate of $32.5 for the period from July 8 through the implementation of final rates. This agreement is subject to the approval of the ISUB.

Alternative Forms of Regulation ("AFOR")

Effective January 1, 1992, the Oregon Public Utility Commission ("OPUC") approved a five year revenue sharing plan. The plan, which will provide greater pricing flexibility, decreased 1991 fourth quarter net income by about $40 as a result of retroactive customer refunds. In addition to the customer refunds, the plan requires the Company to reduce 1992 rates by approximately $68, of which approximately $8 is a temporary reduction.

The Company has existing AFOR plans in the states of Minnesota, Washington, New Mexico, Idaho, Nebraska, North Dakota and South Dakota, and is awaiting regulatory action on proposals in Colorado, Iowa, and Montana.

Postretirement Benefits Other Than Pensions

In addition to pension benefits, the Company provides certain health care and life insurance benefits for retired employees. In December 1990, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard ("SFAS") No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions." Among other things, SFAS 106 requires adoption by 1993 of the accrual method of accounting for postretirement benefits other than pensions. The Company currently recognizes the cost of postretirement benefits as they are paid.

U S WEST, the Company's parent, estimates that its transition benefit obligation that will be recognized upon the adoption of SFAS 106 is a range of $2 to $3 billion before income taxes, most of which is attributable to the Company. While the adoption of SFAS 106 will significantly increase the amount of future postretirement benefit costs recognized for accounting purposes, the Company will seek to recover these increased costs through the ratemaking process. It is not currently possible to reasonably estimate the future impact of SFAS 106 on the Company's earnings. The Company continues to review the effect that health care plan changes, including cost sharing, cost trends and other factors, may have on health care costs.

Employee Relations

In August 1992, labor contracts between the Company and various unions, including the Communications Workers of America and the International Brotherhood of Electrical Workers, will expire. Approximately 37,000 of the Company's 54,923 employees are represented by a union.

1991

NOTE 3: PENSIONS AND OTHER BENEFITS

U S WEST and its subsidiaries have two defined benefit pension plans which cover substantially all management and non-management employees of the Company. Benefits for management employees are based upon a final pay formula while benefits under the non-management plan are based upon a flat-benefit formula. The projected unit credit method is used for the determination of pension cost for financial reporting purposes and the aggregate cost method for funding purposes. No funding was required in 1991, 1990 or 1989.

Net pension credits for 1991, 1990 and 1989 were $96.0, $92.2 and $109.5, respectively.

In addition to pension benefits, U S WEST and most of its subsidiaries provide certain health care and life insurance benefits for retired employees. In 1991, 1990 and 1989, the Company prefunded $55.8, $50.2 and $59.3, respectively, of retiree health care costs. A portion of the prefunded amount was allowed for rate purposes in certain regulatory jurisdictions.

In December 1990, the Financial Accounting Standards Board issued SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions." Among other things, SFAS 106 requires adoption by 1993 of the accrual method of accounting for postretirement benefits other than pensions. The Company currently recognizes the cost of postretirement benefits as they are paid. The cost of health care and life insurance benefits for the Company's retired employees in 1991 was $91.7.

U S WEST, the Company's parent, estimates that its transition benefit obligation that will be recognized upon the adoption of SFAS 106 is a range of $2 to $3 billion before income taxes, most of which is attributable to the Company. While the adoption of SFAS 106 will significantly increase the amount of future postretirement benefit costs recognized for accounting purposes, the Company will seek to recover these increased costs through the ratemaking process. It is not currently possible to reasonably estimate the future impact of SFAS 106 on the Company's earnings. The Company continues to review the effect that health care plan changes, including cost sharing, cost trends and other factors, may have on health care costs.

ATTACHMENT D

Attachment D

UNITED STATES TELEPHONE ASSOCIATION

Analysis of Impact of SFAS 106 Costs on GNP-PI

February 18, 1992

Godwins

BACKGROUND

Godwins has been engaged by the United States Telephone Association to perform an analysis of the impact of SFAS 106 on the GNP-PI. In particular, Godwins was asked to determine the extent to which the price cap mechanism utilized by the FCC will reflect the impact of SFAS 106 and will enable Local Exchange Carriers to recover their increase in total operating costs incurred due to their adoption of the new accounting standard.

This report describes the results of that analysis and provides detailed documentation of the data, methods, and assumptions utilized in the study.

Respectfully submitted,

Peter J. Neuwirth, F.S.A., M.A.A.A.

Andrew B. Abel, Ph.D.

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I. EXECUTIVE SUMMARY

The purpose of this study is to determine what percentage of the additional costs incurred by Local Exchange Carriers subject to Federal Price Cap regulations (hereinafter referred to as "Price Cap LECs") as a result of the Financial Accounting Standards Board's Statement No. 106 (SFAS 106) will be reflected in the GNP Price Index (GNP-PI) and what percentage will not be so reflected.

This study finds that ultimately the increase in GNP-PI caused by SFAS 106 (.0124%) will provide for recovery of 0.7% of the additional costs incurred by Price Cap LECs. Other macroeconomic factors, principally an eventual adjustment of the national wage rate, account for recovery of an additional 14.5% of the additional costs incurred by Price Cap LECs, leaving 84.8% of these additional costs unrecovered.

This study is presented in two stages: an Actuarial Analysis followed by a Macroeconomic Analysis. The Actuarial Analysis uses demographic, economic and benefit program data collected from each Price Cap LEC to construct a composite company (hereinafter referred to as "TELCO") which reflects the characteristics of the industry as a whole. This analysis finds that the impact of SFAS 106 on the costs of the average employer in the economy is only 28.3% of the corresponding impact on TELCO. The Macroeconomic Analysis which analyzes the impact of SFAS 106 on the economy as a whole finds that only 2.3% of the average employer's additional costs resulting from SFAS 106 is passed through to the GNP-PI.

The table on the following page summarizes how the key results of the study are combined to derive the unrecovered proportion of the Price Cap LECs' SFAS 106 costs.